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OCTOBER TERM, 1984

STATE OF TENNESSEE, EX REL.
W. J. Michael Cody,
Attorney General and Reporter,

PETITIONER,

vs.

ELIZABETH H. DOLE, ET AL.,

RESPONDENTS.

On a Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF FOR THE STATES OF ALASKA, ARIZONA, COLORADO, HAWAII, INDIANA, IOWA, KENTUCKY, LOUISIANA, MARYLAND, MINNESOTA, NEVADA, NEW JERSEY, SOUTH DAKOTA, VERMONT, WEST VIRGINIA AND WISCONSIN AS AMICI CURIAE SUPPORTING PETITIONER

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I. INTEREST OF THE AMICI CURIAE

The attorneys general of the amici states submit this brief pursuant to Supreme Court Rule 36.4.

In recent years, the states' road-building projects have been the targets of price-fixing conspiracies entered into by highway construction contractors, resulting in substantial overcharges to the states. The states have initiated a number of actions to recover damages under the antitrust laws, but, as exemplified by this case, the Federal Highway Administration (FHWA) claims entitlement to a significant portion of the damages actually recovered. The amici states therefore have a substantial interest in this case, which decides whether the federal government has a lawful claim to a portion of the states' recoveries.

Additionally, the amici states and their political subdivisions receive federal grants for many kinds of public works and services other than highway construction. If the states recover damages for antitrust injuries sustained in connection with any of these other federally-assisted programs, it is possible that the federal government will seek a portion of the damages in the same way that it seeks a portion of highway bid rigging recoveries. For this reason also, the amici states have a direct and substantial interest in the law governing the federal government's right to share in the states' recoveries in antitrust actions.

II. SUMMARY OF ARGUMENT

A. The decision of the court of appeals conflicts irreconcilably with *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), in which this Court ruled that only those who purchase directly from price-fixing conspirators may recover damages for antitrust injuries.

The primary basis for the *Illinois Brick* decision was the perception that, although it is appealing to try to allocate overcharges among all those injured by antitrust violations, the economic analysis necessary to trace pass-on injuries would overly complicate and reduce the effectiveness of antitrust cases. *Illinois Brick*, therefore, instructed the courts not to undertake the uncertain and difficult task of analyzing elasticities of demand, which would be necessary in order to allocate injury among everyone affected by unlawful overcharges.

In spite of the *Illinois Brick* rule, the Sixth Circuit held that the FHWA was injured by the antitrust violation and entitled to restitution from Tennessee. It then instructed the district court to determine the amount of restitution. This result permits the FHWA to recover damages for antitrust injuries even though it was not the direct purchaser.

In addition, in order for the district court to calculate restitution, it will have to determine first how much the FHWA was injured compared to Tennessee. This allocation of injury simply cannot be accomplished without considering how Tennessee reacted to high construction costs caused by bid rigging conspiracies. If Tennessee reacted by sharply reducing its demand for road construction, the result would be that bid rigging *reduced* total expenditures on road construction in Tennessee, which, in turn, would mean that the FHWA paid Tennessee *less* money because of the bid rigging. Conversely, if Tennessee reacted to the high construction costs brought about by bid rigging by reducing its demand for roads only slightly, the result could indeed be that the FHWA mistakenly paid Tennessee more than it should have. Fundamentally, the elasticity of Tennessee's demand for road construction thus determines the allocation of injury between Tennessee and the FHWA, but *Illinois Brick* precludes the court from analyzing elasticity.

B. Because the Highway Act establishes a fixed amount that the FHWA contributes to Tennessee for road construction, the FHWA has not been injured by the bid rigging conspiracies.

Under the Highway Act, Congress appropriates a lump-sum for highway construction, and the FHWA then follows a statutory formula for apportioning the total funds among the states. 23 U.S.C. § 104 (1982). Once the FHWA applies the formula and determines Tennessee's share of the highway funds, the FHWA cannot exceed that amount. Although bid rigging in Tennessee increased construction prices, the FHWA was completely insulated from the overcharges because its obligation to pay Tennessee was fixed by operation of the statutory formula. Thus, the FHWA's overall obligation to pay Tennessee did not and could not increase at all as a result of the bid rigging conspiracies. The FHWA therefore was not injured. It was only the State of Tennessee that was injured by the bid rigging because the higher costs meant that the state was able to construct fewer miles of road.

C. The Sixth Circuit's ruling will have a substantial monetary impact on the states.

Between 1980 and 1985, nineteen states recovered about $70 million in civil damages from firms and individuals accused of bid rigging on highway construction projects. On the basis of the Sixth Circuit's decision in this case, the FHWA has stated that it will seek a share of other states' recoveries from bid riggers. From Tennessee, it is requesting about 38 percent of the state's total recovery, and if it seeks a similar percentage from the other states, the total loss to the states will be $26 million.

Moreover, the Sixth Circuit's authorization for the federal government to obtain restitution from the states for

antitrust injuries does not just apply in the context of highway bid rigging. Indeed, the court's rule has potential application anytime a federally-funded state project is the victim of an antitrust violation.

III. ARGUMENT

A. The Decision of the Court of Appeals Is Contrary To This Court's Ruling in *Illinois Brick*

At issue in this case is whether the federal government may avoid the rule in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), and recover for antitrust injuries by seeking restitution from the direct purchaser, the State of Tennessee.

Basing its decision on common law notions of restitution, the court of appeals below ruled that the federal government is entitled to a portion of the money Tennessee recovered from individuals and firms charged with rigging bids on federally funded highway construction projects. *Tennessee v. Dole*, 749 F.2d 331 (6th Cir. 1984). In the view of that court, because of the price-fixing conspiracy of the highway contractors, the FHWA mistakenly paid more to Tennessee than it would have in the absence of the conspiracy. According to the Sixth Circuit, the FHWA, in addition to Tennessee, was injured by the antitrust violation, and it would therefore be an unfair windfall to permit Tennessee to retain all the money recovered from the conspirators.

The decision of the court of appeals is directly contrary to *Illinois Brick* because it permits the FHWA to recover for antitrust injuries even though it was not the direct purchaser.

In *Illinois Brick*, this Court ruled that only those who buy directly from price-fixing conspirators may recover

damages for resulting injuries. Further, the direct purchaser is entitled to recover and retain the *entire* amount of the overcharge, even though part of the overcharge was passed on to others who were then, in turn, also injured by the antitrust violation. 431 U.S. at 745-746. The principal basis for the *Illinois Brick* rule was the concern that litigating pass-on issues would tend to deplete the overall recovery and involve courts in the uncertain task of computing elasticities of supply and demand, which would be necessary to apportion damages among injured buyers. 431 U.S. at 741-743. The economic analysis necessary to establish the amount of the passed-on overcharge would greatly complicate and protract antitrust cases, "transform[ing] treble-damage actions into massive efforts to apportion the recovery among all potential plaintiffs that could have absorbed part of the overcharge — from direct purchasers to middlemen to ultimate consumers." 431 U.S. at 737.

For the reasons explained below, the Sixth Circuit's decision requires the district court, on remand, to attempt exactly the same type of apportioning and economic analysis that *Illinois Brick* directed the federal courts not to undertake.

The FHWA argued before the Sixth Circuit that it is entitled to recover from Tennessee the difference between the money it actually paid on the rigged highway projects and the amount it would have paid if the projects had not been rigged. Appellant's Brief at 24-25.[1] The Sixth Circuit

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[1] In its brief to the Sixth Circuit, the FHWA asserted that to determine the amount of overpayment to Tennessee, first one calculates the "correct," non-rigged contract price by subtracting the amount recovered in connection with a rigged project from the project's rigged price. Once the "correct" price is calculated in this way, determining the amount owed to the FHWA is simply a matter of figuring the difference between the amount the FHWA actually paid on the project and the amount it would have paid based on the "correct" price. Thus, if the FHWA paid 90 percent of the rigged price, it would have paid 90 percent of the "correct" price. Appellant's Brief at 24-25.

apparently agreed that this was the proper starting point for calculating the amount of money owed to the FHWA, but it instructed the district court to consider other factors also in arriving at a final figure, such as Tennessee's costs of recovery. 749 F.2d at 331.

Even assuming *arguendo* that the Sixth Circuit was correct in finding that the FHWA was injured and entitled to restitution, reconstructing the amount that the FHWA would have paid if there had been no bid rigging is not nearly as simple as the FHWA would have us believe. Elementary economics teaches that with lower prices for a good, a consumer's purchases of that good will increase. P. A. Samuelson, *Economics*, 54-55 (11th ed. 1980) [hereinafter cited as Samuelson]. Therefore, to reconstruct accurately how much the FHWA would have paid in the absence of rigged construction costs, consideration must be given to how lower, non-rigged prices would have affected Tennessee's demand for road construction.[2] In other words, a proper reconstruction of the harm caused to the FHWA would have to involve consideration of both the "correct" price and the "correct" demand in the absence of bid rigging.[3]

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[2] At page 33 of its brief to the Sixth Circuit, the FHWA acknowledged that inflated costs resulting from bid rigging cause a decrease in the amount of road constructed.

[3] Calculating the "correct" price and the appropriate restitution amount is further complicated by other factors not discussed by the Sixth Circuit. For example, it is not uncommon for bid rigging defendants to have been involved in numerous rigged highway construction projects, some of which were federally funded and some of which were not. Yet when Tennessee obtains damages from these contractors, the settlements provide only for a lump sum payment, making it impossible to apportion the damages between the federally-funded projects and the state-funded projects.

Additionally, Tennessee and other states, recognizing the difficulty of determining the actual dollar amount of damages incurred as a result of bid rigging on a contract, frequently follow rules of thumb in deciding on an amount to seek from defendants. Some states seek damages equal

Highway bid rigging in Tennessee spanned a number of years and involved many individuals and firms, affording the state sufficient time to adjust to the higher rigged prices. If, in the face of the higher construction prices caused by collusive bidding, Tennessee sharply cut back its demand for roads, the FHWA may actually have paid Tennessee *less* than it would have paid in the absence of bid rigging, where Tennessee's demand for road construction would have been greater. In these circumstances, the FHWA did not mistakenly pay out more than it would have in the absence of bid rigging; instead, it mistakenly paid out less. There is no harm at all to the FHWA in this case because Tennessee absorbed all of the injury by sharply reducing its demand for road construction.

Conversely, if Tennessee reacted to the high, rigged prices by reducing its demand for road construction only slightly, then it is possible that the FHWA paid more to Tennessee than it would have if the bidding had been competitive.

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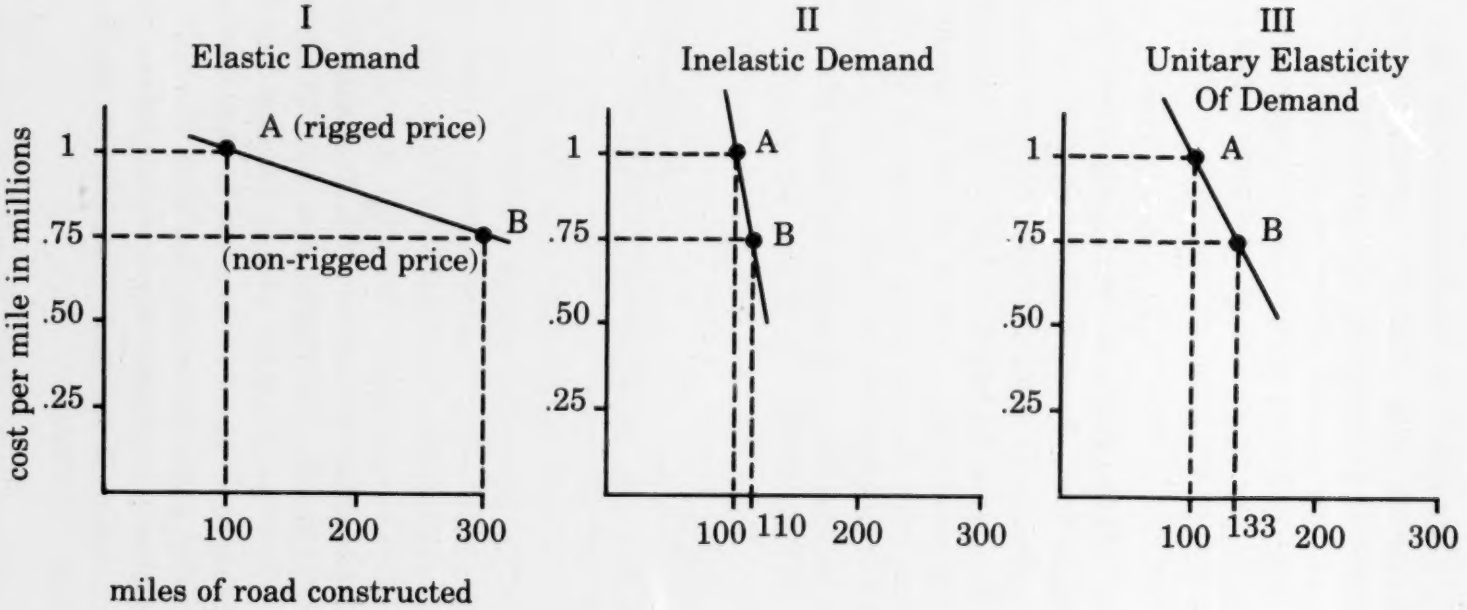
to fifteen percent of the contract price from defendant bid riggers who actually won the contract. The same state, however, may seek only five percent from a defendant bid rigger who submitted a complementary bid on a rigged project but did not win the contract. Other times, states consider the ability of the bid riggers to pay and seek damages equal to ten percent of the defendant's net worth. Because of the different rules used by the states in seeking damages, it is not accurate to assert, as the FHWA does, that the "correct" contract price can be determined by subtracting recoveries from the actual contract price.

Finally, because the states may obtain treble damages from bid riggers, 15 U.S.C. § 15, that fact would certainly be reflected in the size of the settlements the states obtain from the bid riggers. The federal government, however, cannot obtain treble damages. 15 U.S.C. § 15A. Thus, the job of the district court on remand to calculate the amount of restitution is complicated by this factor also. The court must not permit the FHWA to receive the benefit of Tennessee's ability to use the threat of treble damages.

The responsiveness of Tennessee's demand for road construction to higher prices is critically important in assessing injury to the FHWA. In economic terms, the elasticity of Tennessee's demand for roads is the key to whether the FHWA is entitled to restitution. *See generally* Samuelson, 357-359. The three demand curves on page 9 of this brief perhaps better illustrate the importance elasticity of demand plays in determining damage to the FHWA.

TENNESSEE'S DEMAND FOR ROAD CONSTRUCTION



In each of the three diagrams on page 9, the vertical axis measures the cost to Tennessee of constructing one mile of road, while the horizontal axis measures the number of miles of road constructed, or demanded, by Tennessee. The downward-sloping demand curve expresses the relationship between the price of road construction and the amount demanded: as the price per mile falls, more miles of road are demanded by Tennessee.

Assuming that bid rigging raises the price of road construction to $1 million per mile, then in Diagram I, point A shows that 100 miles of road are constructed when there is bid rigging. The total cost of constructing that much road is represented by the area of the rectangle that point A makes with the two axes. Because of the sharing of costs between a state and the FHWA under the Federal Highway Act, Tennessee might pay ten percent of the total cost while the FHWA would pay ninety percent. 23 U.S.C. § 120(C) (1982). Thus, the total cost of road construction in Diagram I is $100 million, of which Tennessee pays $10 million, and the FHWA pays $90 million. In the absence of bid rigging, however, the price per mile would have been lower, say $750,000 per mile, and Tennessee would have demanded many more miles of road. Point B in Diagram I shows that with the non-collusive price of $750,000 per mile, Tennessee would have constructed 300 miles of road. Again, the total cost is represented by the area of the rectangle point B forms within the two axes. The total cost of road construction would be $225 million, of which Tennessee would pay $22.5 million and the FHWA $202.5 million. Diagram I, therefore, portrays the situation where, because Tennessee sharply reduces its demand in response to rigged prices, the FHWA actually pays Tennessee *less* than it would have if there had been no collusion. In economic terms, this is the situation where Tennessee's demand is elastic for the described change in prices.

In Diagram II, point A shows that with the rigged price of $1 million per mile, Tennessee built 100 miles of road at a total cost of $100 million, of which Tennessee paid $10 million and the FHWA paid $90 million. In the absence of bid rigging, the price would have been $750,000 per mile, but this time, as point B in Diagram II shows, Tennessee's demand for roads increased only slightly to 110 miles. The total cost in the absence of bid rigging is thus $82.5 million, of which Tennessee pays $8.25 million and the FHWA pays $74.25 million. In this case, in the absence of bid rigging, the FHWA would have paid less than it actually paid in the presence of bid rigging. Tennessee's inelastic demand for this change in prices accounts for the result.

Diagram III portrays the situation where the FHWA pays the same amount, $90 million, when there is bid rigging and when there is not. This diagram portrays unitary elasticity of demand.

To summarize the diagrams, when there is bid rigging, the FHWA pays Tennessee $90 million as its share of the total costs of road construction. When there is no bid rigging, however, the FHWA's payment varies depending on the elasticity of Tennessee's demand for road construction. When Tennessee's demand is elastic, the FHWA pays $202.5 million; when demand is inelastic, the FHWA pays $74.25 million; and when Tennessee's elasticity of demand is unitary, the FHWA pays $90 million. Therefore, it is only when Tennessee's demand is inelastic that the FHWA is harmed at all by bid rigging. Only where Tennessee's demand is inelastic does the FHWA mistakenly pay out more than it would have if there had been competitive bidding. Where Tennessee's demand is elastic or unitary, the FHWA cannot claim any injury as a result of the bid rigging by contractors.

Under the Sixth Circuit's decision, the district court, in determining the amount of restitution, will have to hear evidence on the elasticity of Tennessee's demand for road construction and how the elasticity has changed over time. Any restitution calculation by the district court that ignores elasticity would be seriously flawed and contrary to principles of both equity and economics. Yet by taking evidence on elasticity and by trying to reconstruct what Tennessee's road-building decisions would have been but for bid rigging, the district court will be trying to make the very determinations that this court foreclosed in *Illinois Brick*. This Court has clearly stated that in determining injury from antitrust violations, the federal courts simply should not embark on the task of measuring elasticities because "it is unrealistic to think that elasticity studies introduced by expert witnesses will resolve the pass-on issue." 431 U.S. at 742. Moreover, "attention to 'sound laws of economics' can only heighten the awareness of the difficulties and uncertainties involved in determining how the relevant market variables would have behaved had there been no overcharge." 431 U.S. at 743.

Illinois Brick was grounded on the judgment that "the antitrust laws will be more effectively enforced by concentrating the full recovery for the overcharge in the direct purchasers than by allowing every plaintiff potentially affected by the overcharge to sue only for the amount it could show was absorbed by it." 431 U.S. at 735. This was such an important concern to the Court that it specifically rejected attempts to carve out exceptions to the *Illinois Brick* rule. 431 U.S. at 744. The Sixth Circuit, however, has created an exception. Under a restitution label, the court denies full recovery to the direct purchaser and permits recovery by one other than the direct purchaser. It is for this reason that the decision of the court below is contrary to *Illinois Brick*.

B. The FHWA Suffered No Injury As A Result Of The Bid Rigging Conspiracy

The preceding argument assumed *arguendo* that the Sixth Circuit correctly ruled that the FHWA may have been injured, but by focusing attention on the funding scheme established by the Highway Act, it is apparent that the FHWA has not been harmed by the bid rigging conspiracies, nor has it unjustly enriched Tennessee through overpayments of highway funds.

Under the Highway Act, Congress appropriates a lump sum for road construction and the FHWA then apportions the funds among the states according to a statutory formula. 23 U.S.C. § 104 (1982). The formula instructs the FHWA, in determining each state's share, to consider factors such as the state's geographic area, population, and the mileage of rural mail routes. 23 U.S.C. § 104(b)(1) (1982). Significantly, the allotment is not affected by the costs of road construction in a state. Therefore, a state that has high construction costs because of bid rigging does not receive more money from the FHWA.

For Tennessee, the FHWA applied the statutory formula and determined the state's share of the funds appropriated by Congress. Once this figure was calculated, it operated as a limit on the amount of money the FHWA could pay to Tennessee for road construction. It was then Tennessee's responsibility to buy the greatest amount of road, given its available resources. No matter how much road Tennessee was able to construct, however, the FHWA's payment to the state would not and could not exceed the statutorily-determined limit. As a result of the higher construction costs generated by bid rigging, Tennessee was not able to purchase as many miles of road as it could have in the absence of bid rigging. The result is that the bid rigging conspiracies injured Tennessee, which now has fewer miles

of road, but the bid rigging could not and did not increase the amount of the FHWA's payment to Tennessee. Otherwise stated, because the Highway Act determines the amount the FHWA pays to Tennessee, the FHWA is completely insulated from injury caused by bid rigging conspirators. *See U.S. v. Azzarelli Construction Co.*, 647 F.2d 757, 761 (7th Cir. 1981). All injury from the conspiracies was inflicted on Tennessee, which was forced to construct fewer miles of road.

This situation is comparable to benefits that households receive under the Food Stamp Act, 7 U.S.C. § 2011 (1982), *et seq.*, administered by the Department of Agriculture. Under the food stamp program, eligible households receive allotments of food stamps based on the household's size, income and expenses. 7 C.F.R. Part 273 (1983). The household then uses the food stamps to purchase food to raise the household's nutrition level. 7 U.S.C. § 2011 (1982). If the household purchases food at participating stores but pays too much for the food by reason of a mistake, fraud or price-fixing, the household is obviously injured because it is able to purchase less food. The U.S. Department of Agriculture, however, is not injured by the inflated food prices paid by the household; the federal government's payment of benefits to the household did not increase at all as a result of the overcharge. In this context, it is easily seen that only the household is injured and that the Department of Agriculture is not entitled to restitution from the injured household.

This same conclusion applies with equal force to the present situation. Tennessee sustained all the injury, and the FHWA is not entitled to restitution.

C. The Rule Of Law Adopted By The Court Of Appeals Will Have A Large Impact On The States

The Sixth Circuit's decision that the FHWA is en-

titled to a share of Tennessee's recovery has the potential for a substantial monetary impact on the states.

From December, 1979 until April, 1984, the U. S. Department of Justice filed 270 indictments or criminal informations in twenty states against about 500 individuals and firms, charging them with rigging bids on highway construction projects. U.S. Dept. of Justice Road Building Cases, 1979 to 1984 (unpublished report). The federal investigation into bid rigging is continuing, and additional indictments are likely.

Because the typical course for a bid rigging case is that state treble-damage actions follow federal indictments, each indicted individual and firm is a possible defendant in a state action for damages. Indeed, the states have been pursuing many damage actions against bid riggers. From December, 1980 until February, 1985, nineteen states recovered almost $70 million from bid riggers, and additional damage actions are currently in litigation. (Compiled from National Association of Attorneys General, *Antitrust Reports*, December, 1980 to February, 1985). The FHWA has stated that it intends to use the favorable ruling from the Sixth Circuit as a basis for seeking reimbursements from states in addition to Tennessee. Appellant's Brief to the Sixth Circuit at 7, n. 6. It is requesting about 38 percent of Tennessee's recovery, and if it seeks a similar percentage from other states, the states will lose $26 million of the $70 million recovery.[4]

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[4] From some states, such as Colorado, the FHWA is requesting about 85 percent of the state's recovery.

The FHWA's request to Colorado should be noted for an additional reason. In its brief to the Sixth Circuit, at pages 47 to 48, the FHWA argued that it is entitled to restitution from Tennessee because the state improperly used money recovered from bid riggers on non-highway projects. Yet in Colorado, where the courts have ordered that all money recovered from bid riggers must be paid to the Department of Highways for use in highway construction, the FHWA nonetheless seeks a very large share of that state's recoveries.

Moreover, because "the federal government makes many hundreds of grants each year to state and local governments", *D.R. Smalley & Sons, Inc. v. U.S.*, 372 F.2d 505, 507 (Ct. of Claims 1967), the Sixth Circuit's decision has potential impact in areas far removed from the Federal Highway Act and road construction bid rigging. Anytime a federally-funded state project is the target of a price-fixing conspiracy, *Tennessee v. Dole* could be used by a federal agency to claim a share of a state's antitrust damages. The states will be relegated to the role of bringing antitrust damage actions on behalf of the federal government.

The states and their political subdivisions receive federal funds for a number of purposes. For example, with federal grants, the states provide health care,[5] construct low-income housing,[6] urban mass transportation systems,[7] and airports.[8] In the past, many of these federally-funded state projects have been victimized by price-fixers. *See, e.g., U.S. v. Allied Asphalt Paving Co.*, 451 F.Supp. 804 (N.D. Ill. 1978) (bid rigging on runway construction at O'Hare Airport); *U.S. v. Borden, Inc.*, No. LR-Cr-77-60 (E.D. Ark. 1977), *reported in* 1970-1979 Transfer Binder, Trade Reg. Rep. (CCH) ¶ 45,077, p. 53,691 (bid rigging on contracts to sell dairy products to schools as part of the school lunch program). Because of *Tennessee v. Dole*, the states will find that the FHWA is not the only federal agency asking for a part of the states' antitrust recoveries. Instead, any federal agency that provides funding for state projects will now be

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[5] 42 U.S.C. § 1396 (1982), *et seq.*
[6] 42 U.S.C. § 1437 (1982), *et seq.*
[7] 49 U.S.C. § 1601 (1982), *et seq.*
[8] 49 U.S.C. § 1101 (1964), *et seq.* (repealed 1970).

able to assert a claim for a portion of the states' antitrust damages.

Additionally, the decision of the court below has potential impact on the states in another way. Because Tennessee, in the Sixth Circuit's view, is not legally entitled to retain the full amount of the recovery, highway bid riggers will see that by combining the decision with the law of standing, they can assert that Tennessee and other states may not bring antitrust actions against them seeking the full amount of overcharges. The bid riggers will argue that recent decisions on standing emphasize that a litigant must assert only his own legal interests, rather than those of third parties. *See, e.g., Warth v. Seldin*, 422 U.S. 490, 509 (1975), *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91, 100 (1979). Thus, the argument from the bid riggers will be that the states lack standing to recover damages that legally belong to the FHWA. If courts accept this argument, the *Tennessee v. Dole* decision will greatly decrease the amount states can recover from bid riggers, thereby further reducing incentives for the states to bring actions to enforce the antitrust laws. Moreover, this result may mean that bid rigging defendants escape the major portion of their liabilities because the FHWA may not be able to sue them directly. *U.S. v. Azzarelli Construction Co.*, 647 F.2d at 758 n. 1 (U.S. conceded that it may not sue bid riggers under the antitrust laws).

Finally, the Sixth Circuit's ruling reduces the ability of the states to provide funds to match road-building funds offered by the FHWA. An example illustrates this point. If a state recovers $1 million from a highway bid rigger, the state can then use the money to match $9 million in road-building funds provided by the FHWA. 23 U.S.C. § 120(c) (1982). But if the FHWA takes ninety percent of the state's recovery, the state then can use the remaining $100,000 to

match only $900,000 in federal funds. Permitting the FHWA to recover from the states vastly reduces the states' ability to finance road construction.

IV. CONCLUSION

For the foregoing reasons, the amici states respectfully submit that the petition for a writ of certiorari to the United States Court of Appeals for the Sixth Circuit should be granted.

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